Trends
AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

Vol. XIII, No. 4 June 26, 1987

DISCOUNTERS' DOZEN YEARS

A dozen years have elapsed since "May Day," May 1, 1975, when the final curtain fell on fixed commission rates. Although discounting and discounters existed prior to that date, this is generally considered the dawn of discounters. Today, discounting is a fact of life for virtually all firms in the securities business. The banking industry is also very much involved in this business. This Trends is an attempt to study the performance of those broker-dealers which are primarily involved in the discount brokerage business. Lack of data prevents studying the growth of discounting, per se, by all firms engaged in securities commission business.

HIGHLIGHTS

1. No matter which interval of years analyzed, or the group of discounters and methodology used, studies have consistently shown discounters improving their share of retail commissions.

2. The profitability of discounters is at least as volatile as that of the total industry. Over the most recent 16 quarters, half the time profits went up, half the time they fell.

3. Discounting is a highly concentrated segment of the securities industry and growing more so. Five firms accounted for 83% of the revenues of all NYSE discounters last year, up from 81% in 1985. These same five accounted for 68% of total revenues of all discounters in 1986, up from 65% the previous year.

4. Discounters' profitability last year outpaced the securities industry. The pre-tax profit margin for discounters was 15% vs. 12% for the industry and their pre-tax return on equity was 46% vs. 29% for the securities industry.

PREFACE

One of the prime reasons that this publication, Trends, was conceived and, indeed, continues today, is a relative void regarding data about the securities industry. Possibly nowhere is that void greater than on data covering discount brokers.

Four years ago, in the March 4, 1983, issue of Trends, we published "A Primer On Discount Brokers," in an effort to fill the discount broker data void, particularly after the Securities & Exchange Commission discontinued supplying data on discounters after its 1980 annual staff report on the securities industry.

In subsequent issues of Trends, updated data on discount brokers were included in those issues dealing with securities industry profitability by firm category. Such reports explore the revenues, expenses, profits, ROE, etc., of different categories of the NYSE member firms which deal with the public. The figures are derived from the quarterly FOCUS reports submitted to the Exchange.

These groups, known as SIA/SEC categories, are familiar to the long-term Trends' reader. Examples are the National Full Line firms, Large Investment Banks, Regional firms, etc.

The discounter group, as with the other categories, dealt with those discounters which were members of the New York Stock Exchange (dealing with the public). The discounters which are members of the NYSE, however, are relatively few in number (currently 27 parent firms), and therefore SIA has, and continues to, expand this firm category to include firms which are not members of the Big Board. Although the number of NYSE discounters is few, historically the NYSE discounters have accounted for the vast majority, about four-fifths, of the aggregate financials of all discount brokers which SIA has identified at different points in time.

The aggregates of all discounters (registered broker-dealers, including their subsidiaries, whose sole or primary business is discount brokerage) were obtained with the assistance of the National Association of Securities Dealers (NASD), from the FOCUS reports filed by their sole members. In the past, as well as in this issue of Trends, whenever total (NYSE and NASD) discounter figures are compared to total industry figures, SIA also expands its "total industry" figures to include both NYSE and NASD (exclusive of double-counting) members which deal with the public. Other than discounter studies, SIA restricts its analysis of securities industry profitability to NYSE-member firms. (This is due to the timeliness and accessibility of data from this group and its overwhelming share of all securities business conducted in the U.S.)

The continuity of SIA's data on discounters is limited in some areas. During the 1980s, and most recently last year, the

SIA/SEC firm categories were periodically updated to reflect added and dropped memberships. This updating also ensures that a firm's classification represents its current business nature and the classifications, themselves, have been adjusted to reflect user demand. This has resulted in a few categories being eliminated, such as clearing firms.

All data in this report for periods 1983 and thereafter reflect the adjusted numbers for the new group of discounters and any comparison of these periods to prior periods warrants caution. Aggregate data is the most affected but ratios, i.e. profit margins, should be affected to a much lesser extent.

Finally, attempts to identify market share of discounters involved assumptions made by the SEC in its reports and assumptions by SIA in Trends.

Thus, the following analysis is made complex by both the number of various data sources which must be tapped, the changes in players identified as conducting discount brokerage businesses as well as the assumptions which were necessary to measure the changing markets.

Nevertheless, the following analysis of the discount brokerage business and its impact and share of total securities businesses is the most detailed and complete publicly available analysis about this group that we know of.

THE EARLY YEARS

A dozen years have passed since the U.S. securities industry's "May Day," May 1, 1975 when the final curtain fell on fixed commission rates. Although certain commission rates were allowed to be negotiated prior to that date and broker-dealers also engaged in the business of discounting prior to that date, this is generally considered the dawn of discounters - A.D. vs. B.C. or After Discounting vs. Bound Commissions, if you will.

As reported in a previous issue of this publication concerning discounters, in the 1970's, the U.S. securities industry underwent significant changes in structure, concentration, and diversification of revenue sources. Most of these changes resulted from economic forces which were driving up prices and interest rates. This, in turn, led to dramatic changes in the demand for services and products provided by the securities industry. Until 1979, there was a sharp decline in the number of securities firms dealing with the public, increasing concentration (the market share of the largest 10 and 25 firms increased noticeably), and a de-emphasis on commission business. With the sharp increase in market volume since 1977, some, but not all, of these trends have moderated. While concentration continued to increase and commission revenues declined in relative importance, the number of NYSE firms doing a public business stopped falling and even increased slightly.

Some, but not all, of these trends were intensified by the SEC's decision to eliminate fixed commission rates on May 1, 1975. This regulatory change reduced the profitability of the institutional brokerage business as institutional rates quickly plunged from their pre-May Day levels.

The demise of institutional research houses was swift and striking. There was also a decimation of the brokerage house ranks following Mayday, but it was more confined to the institutional sector. Retail firms did encounter difficulties in 1977, but these problems stemmed more from poor markets than from the advent of competitive rates.

In the institutional sphere, proprietary trading is viewed as an independent profit center, in no conceivable sense as an adjunct to institutional brokerage as it once was. Hard-dollar research revenues remain negligible, while there appears still to be adequate research coverage of both companies and markets. Liquidity and research were the most important soft-dollar services in the pre-May Day business. They are also services which discount brokers, by and large, do not offer.

The unfixing of commission rates allowed for a new competitive strategy to be employed in offering retail brokerage services. Some new firms entered the industry primarily to attract retail business by offering commission charges well below prices of more established firms. Others already in the business as traders and market-makers or specialist firms became discounters. Such firms used discount brokerage as an opportunity to augment their other operations. Few, if any, of the largest, well-established firms chose to operate solely as a discount broker in terms of market strategy.

For discussion purposes, it is useful to define precisely what is meant by the term "discount broker." Discounters operate almost entirely in the retail business; institutional investors, conscious of both their market power and fiduciary obligations, invariably demand (and get) from full service firms execution at rates well below those that prevailed in April 1975. A "pure" discounter offers only execution, although a variety of services can be found in the discounter field, as discussed below. This discounter execution service is usually offered at a discount of roughly 40-70% off the April 1975 fixed rate level. Discounters are distinguished, too, by their lack of an active sales force, which creates an emphasis upon mass media advertising and execution of unsolicited orders.

As mentioned, discount brokerage existed prior to May Day but the opportunities were very limited. Prior to 1975, broker-dealers discounting commissions on brokerage transactions for retail customers were limited to offering discounts from fixed rates on over-the-counter (OTC) trades or operating as agents between clients and "third market" dealers

(firms making markets in listed stocks who were not members of exchanges). The elimination of fixed rates on May 1, 1975 expanded opportunities for discount brokers considerably by making it possible for exchange members to offer discounted commission rates on transactions in exchange-listed stocks and by enabling non-member brokers to negotiate access to exchanges at lower rates.

When the Securities & Exchange Commission reported on discount brokers in its Staff Report on the Securities Industry in 1978, it identified 35 discounters in existence prior to May 1, 1975, four new firms later that year, nine additions in 1976, four more in 1977 and three additions in 1978. When the SEC revisited the topic in its Staff Report for the year 1980, it identified 70 broker-dealers considered discount brokers which had been established prior to 1976, 12 new entrants in 1976, eight in 1977, nine in 1978, 15 in 1979 and 11 new entrants in 1980, the last year for which the SEC tracked this group of firms (see Table 1).

Table 1

BROKER-DEALERS OPERATING AS DISCOUNTERS

Year	Original	Revised
1975	39*	70
1976	44	82
1977	48	90
1978	51	99
1979	NA	114
1980	NA	125

*The Staff Report for 1978 stated that of the 39, 35 were in existence prior to May 1, 1975, of which only eight had been in existence in 1968.

SOURCE: SEC's Staff Reports on the Securities Industry in 1978 (original) and 1980 (revised).

Though the methodology used by the SEC has on occasion been critiqued, and the problems with tracking this elusive sector of the industry lends itself to criticism from any who attempt to quantitatively assess this industry segment, the following is an outline of the SEC's data on discounters in their initial post-May Day years, before the advent of bank discounters.

DISCOUNTERS' DAWN

Agency commission business was on the rebound in the latter half of the 1970s. Commission revenues in 1977 stood at nearly

the same level as five years earlier. For this discussion on discounters, we'll begin by using the revised figures published by the SEC in 1981, in its Staff Report on the Securities Industry in 1980, the last time the SEC addressed discounter data. As Table 2 shows, industry commissions took off in 1978, up by a third, then increased over 10% the following year and shot up by two-fifths in 1980. Meanwhile, discounters experienced even higher growth in commission revenues, averaging over 50% annual growth in commission revenues over this same time span and showing a remarkable 77% climb in 1980 alone vs. 41% for the industry.

According to the SEC's 1980 figures, discounters' share of industry commissions grew from a 2.3% share in 1977 to 3.8% in 1980. Using their estimates of how much commission revenues were a result of retail business (which held steady at around two-thirds), discounters' market penetration rose from 3.5% in 1977 to 5.7% in 1980 (market penetration defined as share of retail commissions with discounters' commissions assumed to be 100% retail).

Although the number of discounters increased from 90 to 125 over this time frame, the aggregate and growth figures were not materially affected by the new entrants. The 90 firms in existence in 1977 accounted for the vast majority of revenues and virtually all of the profits during these years. The new entrants after 1977, although encouraged into the discounting business by the profitability of the established discounters, as a group lost money in their early years. The nine firms established in 1978 as a group didn't reach their break-even point until 1980 and those established later still hadn't reached their break-even point by 1980's close. Even the 12 firms established in 1976 and the eight firms established in 1977 took until 1978 to reach their break-even point as a group.

When the SEC looked at discounters in its Staff Report for 1978, the commission revenue totals were only 40% to 50% the level of the revised larger group. However, that smaller group of firms was reporting 86% to 88% of all their revenues as commission revenues. The new, larger group of firms in the Staff Report for 1980, showed commissions as 62% of their 1979 and 1980 revenues (this ratio unavailable for earlier years).

In comparison, the securities industry derived about 42% of its revenues from commissions in 1977 and 1978 and about 34% the next two years. For the National Full Line firms (NFLs), the large nationwide retail houses whose retail customer base is largely the targeted customer base of discounters, commissions constituted half of all revenues in 1977, 43% in 1978, 44% in 1979 and only 37% by 1980.

Table 2

DISCOUNTERS' EARLY GROWTH
(Dollar Amounts in Millions)

	1977	1978	1979	1980
Industry Commissions	$3,035.0	$4,036.0	$4,512.0	$6,377.0
Discounters' Commissions	$69.8	$102.8	$136.5	$241.0
Discounters' Share	2.3%	2.5%	3.0%	3.8%
SEC's Estimated Industry Retail Commissions	$1,982.0	$2,736.0	$3,023.0	$4,234.0
Discounters' Market Share of Retail Commissions	3.5%	3.8%	4.5%	5.7%
Commissions' Growth:				
Industry	N.A	+33.0%	+11.8%	+41.3%
Discounters	N.A	+47.3%	+32.8%	+76.6%
Number of Discounters	90	99	114	125

The smaller group of firms showed pre-tax profit margins of 5.1% in 1980 vs. 6.2% for the industry and 15.6% in 1981 vs. 7.7% for the industry. The NFLs had margins of only 4.4% and 6.9% in these two years. Although profit margins for the larger group are unavailable for these years, the revised figures also show discounters outpacing the industry in profit margins in subsequent years: discounters with pre-tax profit margin of 10.5% vs. the industry's 9.8% in 1979 and discounters with 16.6% vs. the industry's 14.1% in 1980. Meanwhile, the NFLs lagged both again with margins of 7.2% and 10.9%, respectively.

PICKING UP THE BALL

By 1981, the advent of discounters was over, the impact of negotiated rates had been studied and restudied and thus most of the brouhaha was over. The SEC discontinued analyzing this industry segment but demand for data on discounters did not diminish. As mentioned, this continues to be one data area insatiable demand persists on - and thus this follow-up SIA study on these firms.

In early 1983, SIA attempted to maintain the continuity of the discounter data previously published by the SEC ("A Primer on Discount Brokerage," Trends, March 4, 1983) in order to fill this void. Table 3 links the last two years of the SEC's updated figures (1979 and 1980) with SIA's follow-up for the years 1981 and 1982, utilizing the methodology used by the SEC in 1981.

The attempt to maintain the continuity of data and follow the SEC's methodology was not 100% successful since the universe of discounters had to be redetermined and assumptions on estimated retail commissions had to be revised. Therefore direct comparisons of years 1981 and 1982 to prior years should be approached with caution.

Table 3

DISCOUNTERS IN 1981 AND 1982
(Dollar Amounts in Millions)

	1979	1980	1981	1982
Industry Commissions	$4,512	$6,377	$6,143	$6,454
Discounters' Commissions	$ 137	$ 241	$ 251	$ 314
Discounters' Share	3.0%	3.8%	4.1%	4.9%
Estimated Industry Retail Commissions	$3,023	$4,234	$3,987	$3,743
Discounters' Market Share of Retail Commissions	4.5%	5.7%	6.3%	8.4%
Industry Revenues	$13,219	$18,594	$22,631	$24,959
Discounters' Revenues	$ 220	$ 389	359	$ 448
Discounters' Share	1.7%	2.1%	1.6%	1.8%
Commissions' Growth:				
Industry	+11.8%	+41.3%	-3.7%	+5.1%
Discounters	+32.8%	+76.8%	+4.1%	+25.1%
Revenues' Growth:				
Industry	N.A	+40.7%	+21.7%	+10.3%
Discounters	N.A	+7.7%	-7.7%	+24.8
Number of Discounters	114	125	131	136

Table 3 shows that the securities industry experienced a 21.7% growth in revenues in 1981 although commission revenues fell 3.7%. This was a continuation of the industry trend where commissions become less and less a major share of total revenues each year: down to 27% in 1981 from 34% in 1980. Discounters, however, showed a small drop in revenues, 7.7%, while a small rise in commissions, 4.1%.

Part of this discounter change is most likely due to the previous mentioned changes needed to pick up the SEC's ball on discounters. Note that discounters' commissions in 1981 and 1982 are back up as a percent of total revenues, 70%, from the

SEC's 1979 and 1980 showing of 62%. The estimated retail portion of total commissions for the industry in 1981 remained fairly constant with the SEC's 1979 and 1980 estimate of around two-thirds. With the changes in mind, the data shows discounters increasing their market share of retail commissions to 6.3% in 1981 despite an overall drop and a percentage share drop in revenues.

For 1982, several parameters remained steady. The securities industry's commissions represented 26% of total revenues vs. 27% the previous year. Discounters' commissions again constituted 70% of their revenues. What did change was the estimated portion of industry commissions which came from the retail segment, 58%, down from 65% in 1981.

Discounters' revenues and commissions jumped 25% from 1981 levels while industry revenues rose 10% and commissions rose half that rate.

Therefore, discounters' share of industry revenues and commissions both rose while their market share, as measured by share of industry retail commissions, continued its upward march hitting 8.4%, as measured in the March 4, 1983, Trends.

Another attempt at refining the group of discounters was attempted in the Fall of 1983. This affected the figures for 1982 but did not attempt to retroactively adjust the discounter data. Since the reader has already encountered numerous versions of annual data in this report, the following will, just for the record, highlight the attempted adjustments as published in Trends, November 25, 1983.

Total industry revenues and commissions were determined to be about 10%' higher than reported earlier but industry commission revenues were still 26% of total revenues. The new group of 159 discounters reported aggregate revenues and commissions at a level of around 20% below what was reported earlier and the share of discounters' revenues attributable to commissions was slightly lower at 67%. The estimated portion of industry commissions attributable to the retail market was lower at 44% and thus the discounters' market share, defined as a percent of this industry retail commission business, was also lower at 6.3%.

The preceding was a review of various past attempts at analyzing discount broker dealer data. One more attempt has been made by SIA to analyze this industry segment. The following is an analysis of a redefined group of discounters and their performance over the past four years.

A DECADE AFTER MAY DAY

In late 1986, SIA again attempted to identify those broker-dealers (both NYSE and NASD members) which were primarily engaged in the discount brokerage business. This

group does not contain the deposit taking institutions which are engaged in discount brokerage as an adjunct to their banking business (and are not subject to SEC review and thus do not file the regulatory FOCUS report from which SIA gathers its data). The primarily engaged requisite means that this report, as was true with the SEC's Staff Reports, does not analyze the growth in discounting per se, but analyzes the growth in the business conducted by those discounters identified in 1986.

Discounting has become a way of life for virtually all firms doing a retail business and it is impossible to track the percentage of business conducted by all broker-dealers, such as National and Regional firms, which was transacted on a discount basis. Therefore, even if a broker-dealer does a majority of its retail business on a discount basis, if that discount business is not the broker-dealer's primary business (e.g. investment banking and principal businesses contribute a significant percentage of total revenues), they are not classified as a discounter. Also, discounters operate discount brokerage clearing subsidiaries as an adjunct to their business (such as Fidelity's National Financial and Quick & Reilly's Q&R Clearing) and the revenues from these operations, clearly a large and important part of discounters' operations today, are included in this analysis.

The group of firms identified as being primarily discount brokers in 1986 were identified from previous lists, directories of broker-dealers, advertisements, numerous assistance from discounters and their own research on discounters, and many hours on the telephone with brokerages to verify the list.[1/]

Despite the fact that different groups of discounters were used in various reports and various estimates were employed to determine industry retail commissions, each report, including the following shows similar trends. The first is that the agency commission business becomes a smaller part of total revenues each year for the securities industry. Commissions were more than half of industry revenues in the early 1970s, fell to around 29% of revenues in 1983 and were down to around 22% last year. Commissions themselves are not shrinking, in fact commission revenues have reached record levels for the past two years, but they are growing at slower rates than other revenue sources, mainly principal business.

1/Special thanks to all who helped make this study possible, particularly a few dedicated friends at the NYSE, the NASD and at Fidelity.

Discounters, however, have kept their commission to total revenue ratio pretty steady since 1983 at around 60%. They also have had higher rates of growth of commission revenues than the industry as a whole over this period. Even in 1984 when the industry experienced a slump, discounters fared better in commission revenues: discounters' commissions fell only 3% from 1983's levels vs. an 11% drop for the industry.

Table 4

DISCOUNTERS
($ Millions)

	1983	1984	1985	1986
Commissions	335.3	325.9	443.0	654.5
Revenues	529.9	595.1	770.0	1,096.8
Expenses	467.6	589.1	701.3	933.5
Pre-Tax Net Income	62.3	6.0	68.7	163.3
	(% of Revenues)			
Commissions	63.3	54.8	57.5	59.7
Expenses	88.2	99.0	91.1	85.1
Pre-Tax Net Income	11.8	1.0	8.9	14.9
	(% Change)			
Commissions	N.A	(2.8)	35.9	47.7
Revenues	N.A	12.3	29.4	42.4
Expenses	N.A	26.0	19.0	41.7
Pre-Tax Net Income	N.A	(90.4)	1,045.0	137.7
	(% Share of Total Industry)			
Commissions	3.4	3.7	4.2	4.9
Revenues	1.5	1.6	1.6	1.8
Pre-Tax Net Income	1.4	0.3	1.3	2.3
Estimated Retail Commissions*	5.1	5.6	6.4	7.3
No. of Firms	106	120	117	122

*Retail commissions are estimated to be two-thirds of total commissions.

Table 5

TOTAL INDUSTRY
($ Millions)

	1983	1984	1985	1986
Commissions	9,840.4	8,763.3	10,432.9	13,430.1
Revenues	34,336.4	37,048.0	46,844.3	61,017.7
Expenses	29,810.7	34,908.5	41,459.2	53,905.5
Pre-Tax Net Income	4,525.7	2,139.6	5,385.1	7,112.2
	(% of Revenues)			
Commissions	28.7	23.7	22.3	22.0
Expenses	86.8	94.2	88.5	88.3
Pre-Tax Net Income	13.2	5.8	11.5	11.7
	(% Change)			
Commissions	N.A	(10.9)	19.1	28.7
Revenues	N.A	7.9	26.4	30.3
Expenses	N.A	17.1	18.8	30.0
Pre-Tax Net Income	N.A	(52.7)	151.7	32.1
No. of Firms	4,027	4,867	5,714	6,387

While discounters' revenue growth was outpacing the industry, so was the growth in their expenses. In 1984, discounters' expenses increased 26% outstripping a 12% growth in revenues for a 90% drop in profitability. This resulted in a razor thin pre-tax profit margin of only 1%. The industry also saw a drop in profitability but less severe, down 53% vs. discounters' 90% fall. The industry profit margin was slashed also to 5.8%, but that's still much higher than the discounters' 1%. Even the previous year, 1983, discounters' profit margin was below the industry average, 11.8% vs. 13.2%. Meanwhile, the National firms fared even worse, dropping into the loss column in 1984 from a relatively low profit margin stance of 8.6% in bull market year 1983.

As the market returned to good times in 1985, discounters pretty much mirrored the performance of the total industry. Gains in revenues for discounters, NFLs and the industry all rose around 26% to 29%. In all cases, this outpaced by a good margin increases in expenses which averaged 19% to 20% for these three categories of firms. But by just mirroring this performance, it still left the discounters' profit margins sitting somewhere between that of the NFLs and the total industry. Discounters' margins were 8.9% vs. 11.5% for the industry and 5.6% for the NFLs.

Last year was a phenomenal year for the securities industry. Improvements in businesses, profits, and profitability ratios were felt in most segments of the

securities industry. Retail activity on the New York Stock Exchange shot up 25% while on the Amex it rose 55%. Since the listed equities business makes up about two-thirds of the discounters' commissions, this was bound to translate into higher revenues. Discounters' commissions rose 48% while overall revenues climbed 42%. Clearly, in 1986 discounters increased their penetration of this growing commission business. The total industry's commission revenues rose a lesser 29% as did their total revenues, up 30%. The NFLs followed a similar growth pattern as the total industry experienced.

Discounters' share of total commissions climbed from 3.4% in 1983 to 4.9% last year. Their share of revenues and profits also peaked last year. Based on informal surveys of SIA member firms, we estimate that two-thirds of industry commissions are from the retail area. This pretty much matches the previous SEC estimates. And while discounters' commissions are not 100% retail, they are not very much south of that mark and therefore in estimating discounters' share of retail commissions we will again use all discounters' commissions vs. our estimate (two-thirds of total) of industry retail commissions. This shows discounters' market penetration of the retail commission business climbing from 5.1% in 1983 to 7.3% last year. While earlier reports showed this level already eclipsed, again these figures are from a revised list which we feel is substantially correct for "pure" discounters.

The growth in expenses for these groups only slightly lagged each group's revenue gains. However, while the discounters' showed the biggest growth in expenses, their high growth in revenues allowed them to not only improve their profit margins the most, they also showed a higher margin than the industry, the first time they managed this over these four years: discounters' pre-tax profit margin hit 15% vs. the industry's 12% and NFLs' 7%.

Using another measure of profitability, pre-tax return on equity capital (ROE), shows that relative to the whole spectrum of securities firms, discounters were also mirroring overall trends in the brokerage industry for the years 1983 through 1985. Only last year, again, did discounters really show any quantum leap in performance relative to all brokers.

Table 6

PRE-TAX RETURN ON EQUITY
(In Percent)

	1983	1984	1985	1986
Discounters	35.8	2.7	26.2	45.6
Total Industry	34.6	14.0	29.8	28.8
National Full Line	28.1	(2.6)	17.9	20.3

The volatility of the profitability of the discount brokerage business at least equals the volatility for the industry. As a colleague once said, in trying to predict whether profits will be up or down for the securities industry in any given quarter from the previous quarter, you have just as much chance of being correct if you flip a coin as you would if you spent months on regression analysis.

Over the past 16 calendar quarters, discounters experienced eight quarters with rising profits and eight with falling profits. The industry fared only slightly better: nine were up, seven were down.

Though 1986 was the record year for both discounters and the total industry, it was largely a success based on the first quarter results. This was also true for the industry, but not as dramatic. This year's first quarter, however, will eclipse 1986's first quarter. Based on the NYSE discounters (making up 80% of total discounter data), new records in commissions, revenues and profits will be set (this holds true for the total industry as well). The projection for Q1 1987 is that discounters' share of total commissions will rise to 5.3%, to 2.1% of total revenues and to 2.8% of total pre-tax profits.

CONCENTRATION

There is one overriding factor which must be kept in mind when analyzing or utilizing the preceding data on discounters, and that is the concentration within this industry segment. The securities industry itself is a concentrated industry. Last year, the 10 largest capitalized firms accounted for 57% of total revenues of NYSE member firms (dealing with the public). They also accounted for almost half of the total revenues of all NYSE and NASD member firms.

When it comes to discount brokers, the concentration level is even higher. Last year, five discounters accounted for 83% of the revenues of NYSE discounters. They also accounted for 68% of the revenues of all discounters. Concentration increased from 1985 when these two figures were a slightly lower 81% and 65%, respectively.

CUSTOMERS & DEMOGRAPHICS

According to Market Facts, Inc., in the latest of its studies on discounters, "Discount Brokerage Update '87," at the beginning of this year 3.6% of U.S. households have an active discount account. That was double the level for 1983, only 1.5%. Comparing that to Bureau of the Census figures, households with any type discounter account grew about 150% since 1983, going from around 1.3 million households to 3.2 million by January, 1987. The study also found that an additional 11% of households had used a discounter in the past but not currently and 85% of households have never used a discounter.

As mentioned earlier, the bread and butter revenue source for discounters is commissions and of that listed equity business is king. Also shown earlier was that discounters were gaining in this area relative to the total industry and their competitors. Market Facts' survey supports this trend. It found that 58% of all the transactions of clients of discounters only were in corporate stocks. That stacked up against 52% for clients of full service firms only and 49% for clients with any type brokerage account. The next highest type of product was mutual funds which accounted for about 16% of all transactions regardless of what type brokerage account was used.

When it came to the proportion of all dollars, the difference was even more striking. Market Facts shows 76% of transaction dollars from clients with only a discounter account come from corporate stocks vs. 41% from clients with just a full service account and 36% for any brokerage account.

That NFLs (as well as Regional and other type full service firms) are competing with discounters is supported by the Market Facts study. In their "Update '86" study, Market Facts breaks down the type of firms used by the households with a current account at any type of discounter. Of these clients, 52% had a current account with a nationwide discounter while 54% also held current accounts with full service firms. These discount clients also held accounts with banks and thrifts, 42%, while only 18% had current accounts with local independent discounters. Using these figures for nationwide vs. local discounters only, it shows 75% of this smaller group have accounts at the nationwide discounters. This supports the concentration figures shown earlier.

Finally, although the geographic breakdown of discounters by number of offices is unavailable, we can look at these discounters by the states in which they are headquartered. New York was number one with 29 discounters headquartered there (all but five of which were in New York City); Florida's unique demographics placed it second with 13 discounters ahead of California's 11; Texas was fourth with seven while Missouri and Massachusetts tied for fifth with a half dozen discounters each.

CONCLUSION

No matter the interval of time measured nor the group of firms and methodology used, it is clear that discounters have continuously increased their share of the retail commission business relative to the total industry. This is partly due to the fact that discounters, by their nature, are still primarily in the retail commission business while the industry has more

and more turned to principal and investment banking businesses as their primary revenue source. As noted, the total securities industry derived more than half of its revenues from commissions in the early 1970s which has dwindled to around one-fifth today.

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VOLUME

	APRIL 1987	YTD 1987	APRIL 1986	YTD 1986	% CHAN YTD 1987-1986
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	187.1	186.0	147.3	147.9	25.8%
AMEX (MILS.)*	14.4	15.0	13.7	13.7	9.5%
NASDAQ (MILS.)*	144.3	151.9	128.2	122.6	23.9%
REGIONAL EXCHANGE (MILS.)*	28.2	28.3	23.8	24.8	14.1%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$172,672	$645,221	$128,376	$465,697	38.5%
AMEX (MILS.)	4,369	19,519	4,299	14,677	33.0%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	13,140	47,144	11,307	38,174	23.5%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	19,575	77,050	21,151	80,667	-4.5%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.2%	50.7%	49.1%	49.3%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	18,715	70,175	17,755	65,227	7.6%
AMEX OPTIONS	4,766	18,065	4,724	17,437	3.6%
COMMODITY	23,203	71,867	17,338	64,520	11.4%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

UNDERWRITING

	APRIL 1987	APRIL 1986	% Change 1987-1986
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$21,526.0	$33,608.8	-36.0%
Common Stock	$3,212.5	$5,038.5	-36.2%
# of Common Stock Issues	79	111	-28.8%
Preferred Stock	$644.5	$871.0	-26.0%
# of Preferred Stock Issues	8	14	-42.9%
Corporate Debt	$17,669.0	$27,699.3	-36.2%
# of Corporate Debt Issues	192	251	-23.5%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$7,513.9	$11,249.3	-33.2%
# of Issues	113	157	-28.0%
Competitive	$2,140.9	$4,119.0	-48.0%
# of Issues	102	135	-24.4%

Source: IDD Information Services

PRICES
(END OF MONTH)

	APRIL 1987	APRIL 1986	% CHAN YTD 1987-1986
DOW JONES INDUSTRIALS	2286.36	1783.98	28.16%
STANDARD & POOR'S 500	288.36	235.52	22.44%
NYSE COMPOSITE	162.86	135.75	19.97%
AMEX MARKET VALUE INDEX	325.19	268.97	20.90%
VALUE LINE COMPOSITE	259.21	238.60	8.64%
NASDAQ COMPOSITE	417.81	383.24	9.02%

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Comparison of Individual Taxation of Long- and Short-Term Capital Gains on Portfolio Stock Investments in Seventeen Countries	Through the Tax Reform Act of 1986, both short- and long-term capital gains will be subject to a 28% (33% in some cases) tax rate beginning 1/1/88. However, although the taxation of short-term gains has been reduced, the U.S. still maintains capital gains rates that are generally higher than 11 major foreign industrial and six Pacific Basin countries surveyed. This SIA-commissioned Arthur Andersen survey explains capital gains taxation in foreign countries and compares results in a concise table.	SIA Publications Department
Report on Production & Earnings of RRs in 1986	SIA's 14th annual report based on input from 60 member firms employing over 52,000 salespeople across the country. The average production of retail RRs hit a record $243,845 in 1986, while institutional RRs' production came in at $1,094,159. The 87-page Report contains detailed data on production, average payout percentages, RR earnings, and branch managers' compensation.	SIA Surveys Department SIA members: $ 400 Non-members: $1,200
"The Largest Money Managers"	The nation's 100 largest money managers reported a healthy 22.4% increase in total assets under management and a 23% increase in tax-exempt assets in 1986. Extensive rankings and detailed directory of money managers, including size of assets managed, chief officers, and general portfolio mix.	Pensions & Investment Age Special profiles issue 5/25/87

Item	Description	Source
"The Big Bet--The Dilemma of Bridge Financing"	For securities firms, making a bridge loan -- a short-term loan made by an investment bank to fund the initial cash portion of a LBO or recapitalization -- is the ultimate gamble on its own ability to sell the company's junk bonds at a later time to pay itself back. For corporations, bridge loans are so quick and easy that they are becoming less a financing technique of last resort and more like a commodity service that clients expect to get from any investment bank. Investment bankers discuss the high risks and rewards of bridge financing.	Investment Dealers' Digest 6/1/87
"Uncommon Convertibles"	Deciding whether to invest client funds in a company's common stock or a convertible bond is not a simple matter. The attraction of the CB relative to the stock is that it almost always offers a higher yield and yet also offers the potential for capital gains if the market value of the stock should rise. Article explains steps to determine whether to invest in the CB or common stock of a company.	Registered Representative May 1987
"The Way It Was"	A history of the past 20 years offered by over 100 industry leaders who have shaped the current global financial community. Contributing to this retrospective collection are Walter Wriston, David Rochefeller, Bernard Cornfeld and James Needham, among others.	Institutional Investor 20th Anniversary Issue June 1987

Securities Industry Trends

A8825-1
8/25/87

ANNUAL
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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

Vol. XIII. No. 5 August 20, 1987

HIGHLIGHTS

The Growth In Primary And Secondary Activity In International Markets

- International issuers and investors find alternative means of financings preferable to traditional bank financings. "Securitized" financings, which accounted for 44.1% of funds raised on the international financial markets in 1982, now account for 87%.
- Despite the five year bull market, U.S. equity markets have lost considerable ground to foreign equity markets and now account for only 39% of worldwide market capitalization compared to 61% in 1975.
- Since 1980, foreign net purchases of U.S. Treasuries averaged $17 billion per year, reducing the upward pressure that "crowding out" would have had on U.S. interest rates.
- U.S. corporations are taking to international markets in increasing numbers to raise both debt and equity capital.
- During the 1980s, broker-dealers expanded their sales forces overseas rapidly.

THE GROWTH IN PRIMARY AND SECONDARY ACTIVITY IN INTERNATIONAL MARKETS

This issue of Trends will summarize a recently completed SIA study, The International Market: Growth In Primary and Secondary Activity. The purpose of the study was to detail the expansion of global capital markets.

Due to the study's length, this issue of Trends will only cover sections on worldwide equity market capitalization, foreign trading in U.S. securities, Euroequity offerings, Eurobond offerings, pension fund flows and deregulation. The full study includes additional information on foreign exchange turnover, the swap market, derivative products, mutual and country funds and Euronotes and Eurocommercial paper.

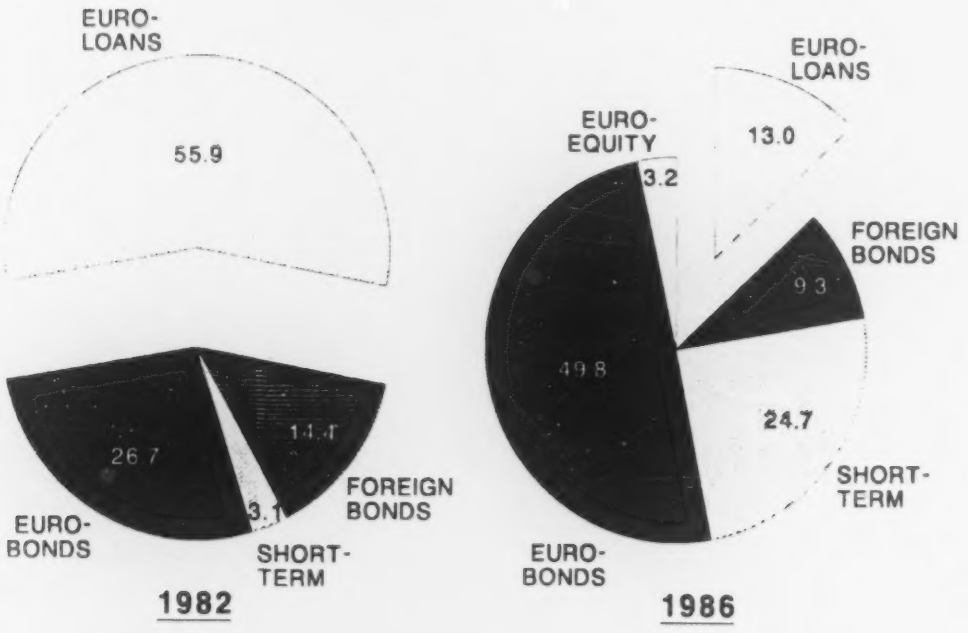
Copies of the full study can be acquired by completing the attached (blue) order form.

The dramatic growth in primary and secondary activity in international markets began in the 1970s, when high inflation and skyrocketing nominal interest rates began to make traditional bank intermediation, such as loans, an increasingly unattractive vehicle to both lenders and borrowers. Issuers in the 1980s, with a global bull market and the experiences of the past decade well in mind, turned to securitized financings as a more flexible and attractive way to borrow. Investors also benefitted, as they were offered a myriad of products through which they could meet their specific portfolio needs.

The following graph underscores the trend toward "securitized" products: in 1986, "non-securitized" products accounted for 13.0% of funds raised in the international financial markets, down a whopping 42.9 percentage points from the 55.9% market share in 1982.

Not surprisingly, U.S. broker-dealers have built upon their fundamental domestic strengths and expertise, along with distribution and capital, to match the demanders and suppliers of global capital. In this regard, U.S. broker-dealers have been busy setting up and expanding overseas offices and services to meet the needs of clients in the international markets.

COMPARISON OF SECURITIZED TO NON-SECURITIZED PRODUCTS, 1982 vs. 1986



WORLDWIDE EQUITY MARKET CAPITALIZATION

Changes in the market capitalization of different stock markets throughout the world emphasizes the increased opportunities available in stock markets outside the U.S. As the table indicates, other countries, in particular Japan, have been gaining ground rapidly over the past few years. During the past 12 years, U.S. markets have seen their share of the world's equity capital shrink from over 61% to just over 39%.

Reduced regulation in foreign markets has played a role in lessening the dominance of U.S. exchanges. The combined impact of deregulation and the offering of government owned companies to the public, privatization programs, has made some foreign markets more attractive relative to the U.S. market while simultaneously increasing their capitalization. Some of the recent decline in the relative dominance of U.S. exchanges has been due to a strengthening of foreign currencies relative to the U.S. dollar; this is particularly true of the Japanese yen.

STOCK MARKET VALUE, EXCHANGE-LISTED DOMESTIC COMPANIES
($ Billions)

	MARKET VALUE				% Of Total		
	1975	1980	1985	1986	1975	1985	1986
United States*	$ 704	$1,237	$1,946	$2,199	61.2%	48.6%	39.2%
Japan**	142	379	948	1,784	12.3	23.7	31.8
United Kingdom	86	205	353	473	7.5	8.8	8.4
Germany	51	72	184	258	4.4	4.6	4.6
Canada***	51	118	157	185	4.4	3.9	3.3
France	35	55	79	153	3.0	2.0	2.7
Italy	11	25	58	140	1.0	1.4	2.5
Switzerland	17	43	84	129	1.5	2.1	2.3
Australia	20	60	60	94	1.7	1.5	1.7
Netherlands	18	29	59	84	1.6	1.5	1.5
Sweden	2	13	37	63	0.2	0.9	1.1
Belgium	9	10	21	37	0.8	0.5	0.7
Denmark	4	6	15	17	0.3	0.4	0.3
Total	$1,150	$2,252	$4 001	$5,616			

Source: Salomon Brothers Inc and International Federation of Stock Exchanges

* Excludes value of domestic listed companies on NASDAQ and Regional Exchanges.

** Excludes value of domestic listed companies on the Osaka Exchange.

*** Excludes value of domestic listed companies on the Montreal Exchange.

The growth of non-U.S. equity markets has important implications for U.S. and other broker-dealers. The performance of these markets eventually had to catch the eye of portfolio investors and persuade them to at least diversify some part of their portfolios in those markets growing the fastest. Hence, to accommodate such needs, U.S. broker-dealers have had to increase their research facilities and trading capabilities in foreign stock markets.

FOREIGN TRADING IN U.S. SECURITIES

A much more explosive catalyst to the growth of international markets has been the interest by foreigners in U.S. securities of all kinds. Foreign investors have a long

history of investing in U.S. securities markets. For instance, as far back as the 1950s, foreign holding of U.S. equities was about 3% of the market value of NYSE listed shares.

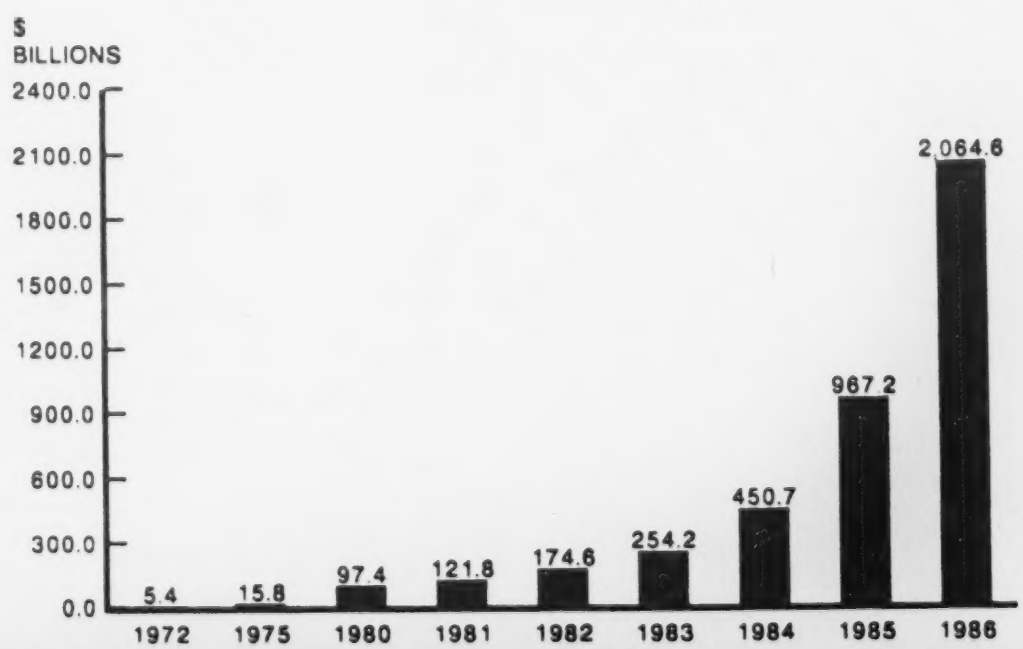
The 1980s have witnessed advances in technology that have allowed for the geographical separation of borrower and lender, growing trade imbalances and a trend toward deregulated markets unparalleled in history.

Simultaneously, the major financial markets have been blessed with low rates of inflation and downward trending interest rates, making financial assets more attractive relative to physical assets. These changes unleashed forces resulting in the explosive growth in international capital flows, much of which found its way into U.S. securities. The downward trending dollar, beginning in the autumn of 1985 and continuing through the first quarter of 1987, has made the purchase of U.S. financial assets "easier on the foreign investor's wallet." Not surprisingly, foreign investors were net purchasers of a record $86.4 billion worth of U.S. securities in 1986.

U.S. Treasury Notes & Bonds

Historically, the U.S. Treasury market has offered investors the largest and most liquid and efficient government bond market in which to trade. These market-oriented characteristics, coupled with the political and economic stability of the U.S., cause foreign investors to consider U.S. Treasuries a relatively safe investment.

GROSS ACTIVITY IN U.S. TREASURIES BY FOREIGN INVESTORS



Foreign investors' activity in U.S. Treasuries exceeded $2 trillion in 1986, nearly greater than all the activity generated during 1980 through 1985 combined. To service such a large market, U.S. securities firms have found it worthwhile to build up extensive trading and sales networks to inform their foreign customers about the desirability of investing in

FOREIGN GROSS ACTIVITY IN U.S. TREASURY NOTES & BONDS
($ Billions)

	GROSS						
	CANADA	JAPAN	SINGAPORE	SWITZER-LAND	UNITED KINGDOM	WEST GERMANY	ALL
1986	57.1	570.8	41.5	50.0	443.9	56.6	2,064.6
1985	41.9	172.5	41.1	18.4	187.6	31.0	967.2
1984	20.7	30.5	36.4	8.7	87.6	25.3	450.7
1983	6.9	16.5	20.0	5.8	43.8	13.3	254.2
1982	2.2	12.8	12.1	4.1	37.2	14.2	174.6
1981	1.7	10.1	2.5	1.2	28.9	12.1	121.8
1980	1.0	6.6	0.2	1.7	33.0	7.0	97.4
1975	0.3	0.3	N/A	0.006	1.1	0.3	15.8
1972	0.6	3.8	N/A	0.002	0.7	N/A	5.4

FOREIGN NET ACTIVITY IN U.S. TREASURY NOTES & BONDS
($ Billions)

	NET						
	CANADA	JAPAN	SINGAPORE	SWITZER-LAND	UNITED KINGDOM	WEST GERMANY	ALL
1986	0.8	3.8	0.6	0.4	4.7	7.8	24.3
1985	(0.2)	17.9	1.6	0.8	(2.0)	1.9	29.0
1984	1.5	6.1	1.4	0.6	5.2	3.0	21.4
1983	0.7	2.3	(1.2)	0.04	2.0	3.7	5.4
1982	0.09	0.8	1.9	0.7	(0.02)	5.3	17.3
1981	0.07	1.3	0.02	0.01	(0.6)	1.1	15.0
1980	0.22	(1.7)	0.004	(0.4)	0.9	(2.9)	4.9
1975	(0.3)	(0.2)	N/A	0.003	(0.1)	0.2	2.0
1972	0.4	2.7	N/A	0.001	*	N/A	3.3

N/A Not Available

* Less than one million

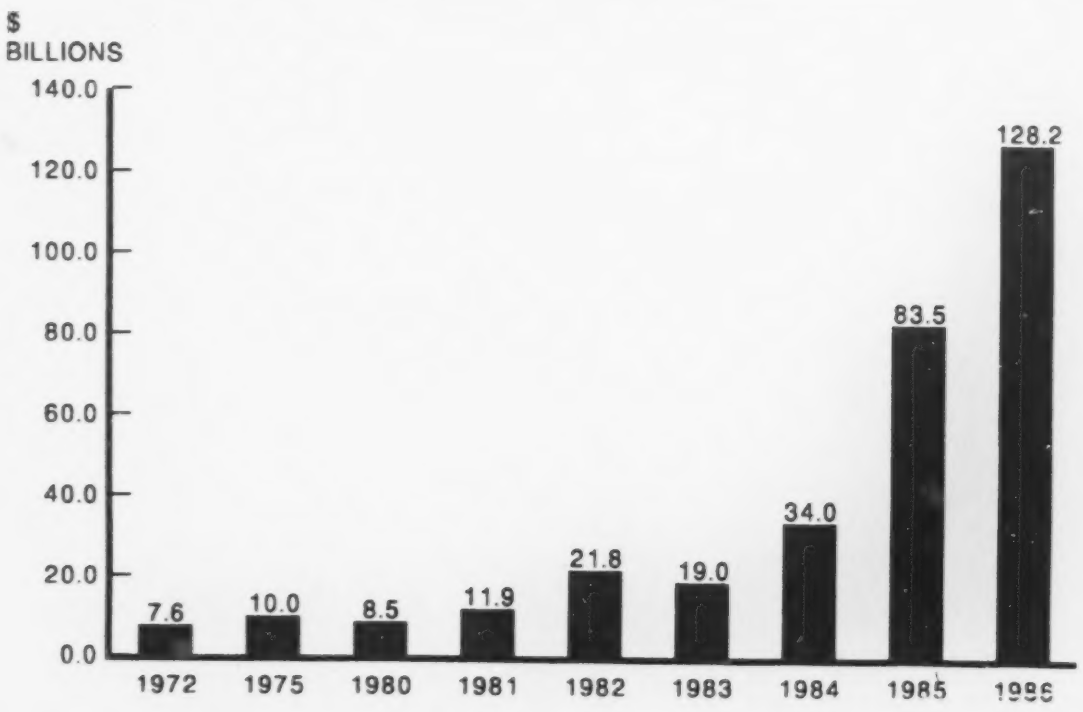
Source: U.S. Treasury

Treasuries. Part of the increase in Treasury activity by foreigners was due to the significant appreciation in the price of Treasuries during 1986. In addition, volatile interest and foreign exchange rates added to the velocity at which these instruments were traded. Finally, the increase in the use of Treasury options and futures domestically and internationally increased the desirability in trading U.S. Treasuries.

A look at the preceding table shows two interesting aspects of the U.S. Treasury market: 1) commensurate with the burgeoning U.S. budget deficit, foreign activity also has increased; and 2) Japanese penetration into the U.S. Treasury market is a fairly recent phenomenon according to "official" data sources.

Until 1984, U.K. investors' gross activity in U.S. Treasuries was generally three times that of Japanese investors. In 1985, however, this "trading gap" closed significantly and, in 1986, Japanese investors surpassed U.K. investors as the most active traders of U.S. Treasuries. Japanese investors, armed with huge capital surpluses and a liberalization of the policies which limited non-yen investments in institutional portfolios, most certainly will sustain this increased activity for the foreseeable future.

GROSS ACTIVITY IN U.S. CORPORATE DEBT BY FOREIGN INVESTORS



U.S. Corporate Debt

Spurred on by heavy domestic and Eurobond issuance by U.S. corporations in 1984-1986, foreign gross and net activity in U.S. corporates grew substantially. In addition, the repeal of the foreign withholding tax on interest payments in 1984 increased the appeal of U.S. corporate debt to foreign private investors.[1/]

Gross activity, which reached $128.2 billion in 1986, is over 1400% greater than 1980's $8.5 billion. In addition, net purchases of corporates have been on the rise since 1983.

FOREIGN GROSS ACTIVITY IN U.S. CORPORATES
($ Billions)

	GROSS				
	UNITED KINGDOM	WEST GERMANY	SWITZER-LAND	JAPAN	ALL
1986	71.5	10.6	9.5	12.8	128.2
1985	45.7	7.7	6.4	6.5	83.5
1984	13.9	4.3	2.7	1.9	34.0
1983	5.0	3.1	2.3	1.3	19.0
1982	5.5	4.6	1.3	1.1	21.8
1981	2.7	1.5	0.8	0.4	11.9
1980	1.5	0.7	0.6	0.1	8.5
1975	3.7	0.2	0.5	0.1	10.0
1972	2.8	0.3	0.9	0.3	7.6

FOREIGN NET ACTIVITY IN U.S. CORPORATES
($ Billions)

	NET				
	UNITED KINGDOM	WEST GERMANY	SWITZER-LAND	JAPAN	ALL
1986	32.8	(.3)	4.5	5.1	43.5
1985	30.5	2.1	3.9	3.0	39.8
1984	8.7	1.6	0.6	0.7	11.9
1983	0.2	0.2	0.6	0.5	10.9
1982	0.1	1.9	0.2	(0.1)	1.8
1981	0.5	0.7	0.1	0.2	3.5
1980	0.1	0.2	0.1	0.01	2.9
1975	(0.1)	(.01)	0.1	(0.05)	0.8
1972	0.4	0.08	0.1	0.3	1.9

Source: U.S. Treasury

1/ The growth in foreign activity in U.S. corporates is somewhat misleading. Starting with 1985, U.S. Treasury data incorporated Eurobond issues into the corporate bond flows for the first time. However, due to the reasons noted above, substantial growth no doubt occurred.

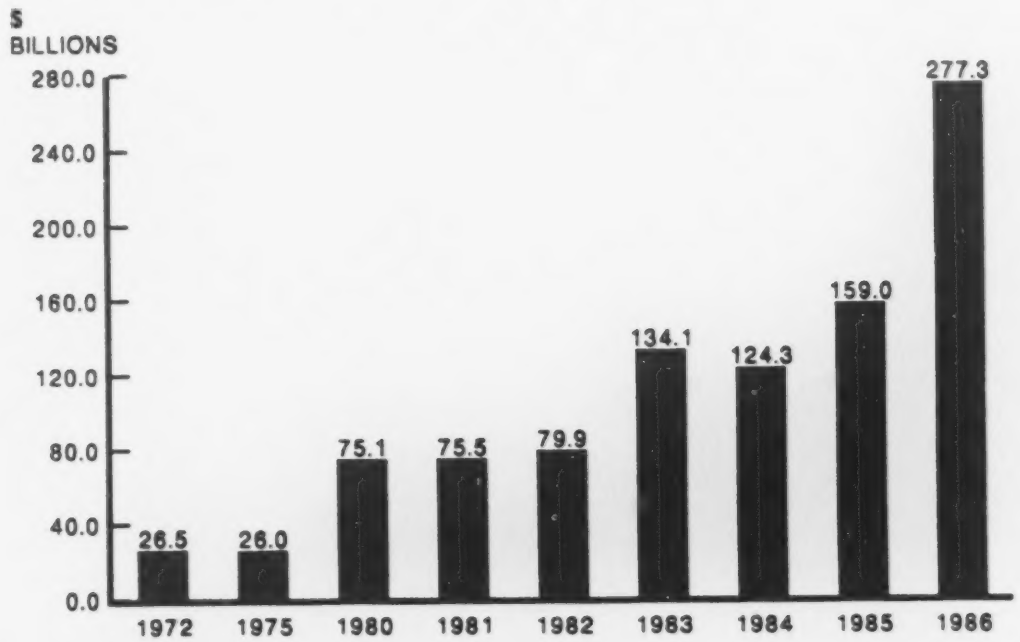
This inflow into the corporate sector helped to lessen the "crowding out" effect by government borrowing which would otherwise have driven interest rates higher. Interestingly, while most attention has been given to net purchases of U.S. Treasuries, foreign net purchases of U.S. corporates have outpaced that of Treasuries during 1985 and 1986 according to official data sources.

U.S. Equities

Foreign activity in U.S. equities also has shown significant growth since the beginning of the 1980's. Gross activity by foreigners has shown a 269% increase when comparing 1980 to 1986.

Foreigners' gross activity in U.S. equities seems to follow a trend: a plateau is reached, gross activity levels off and then a new plateau is reached. For instance, in 1980 to 1982 foreign gross activity stayed in a relatively steady range, averaging $77 billion. The period 1983 to 1985 saw gross activity increase to an average of $139 billion and in 1986 topped the scales at $277 billion.

GROSS ACTIVITY IN U.S. EQUITIES BY FOREIGN INVESTORS



From 1982 on, U.K. investors have shown the most interest in U.S. equities. Prior to U.K. investors, the Swiss were most active (yet showed little in the way of net purchase/net sale activity). Recently, Canadian and especially Japanese investors have shown interest in U.S. equities. The traditional interest by foreigners in U.S. equities explains the original setting up of branch offices overseas, particularly in Europe. However, it appears that the growth in foreign interest in U.S. Treasuries and corporate securities has had more of an impact on the expansion of U.S. firms' trading, sales, operations and other personnel areas overseas than the traditional product line of U.S. equities.

EUROEQUITY OFFERINGS

Continuing record levels of Eurobond issuance overshadow growth in the Euroequity market. However, the equity market is quickly moving from a basically domestic market to an international one. For example, Euromoney's list of international equity issues (issues traded on a daily basis on at least one market outside its home market) has increased from about 240 in 1983 to 493 in 1986. While the tremendous increase in secondary market equity flows is impressive, growth in the Euroequity primary market has been just as substantial. As the table below indicates, almost $12 billion was raised through Euroequity offerings in 1986. This is over double that issued during the period 1983 to 1985.

EUROEQUITY OFFERINGS, 1983-1986
($ Billions)

		Issued By U.S. Corporations	
	Total	Total	# Of Issues
1986	$11.8	$1.65	33
1985	3.5	0.08	3
1984	1.2	0.03	1
1983	0.2	0.00	0

Source: Euromoney

Not surprisingly, continued growth in Euroequity offerings are leading U.S. and other financial intermediaries to add overseas corporate finance staff with expertise in equities as a means of raising capital in the primary markets as well as creating a distribution network to place this capital.

EUROBOND OFFERINGS

The explosion in Eurobond market financing in the period 1980 to 1986 led many to first take notice of a mature and

growing market. As one of the world's premier capital markets, Eurobond issuance totaled $183 billion in 1986, with secondary market activity exceeding $3 trillion. U.S. broker-dealers play a significant role in this market; since 1982, they have accounted for over 35% of the volume of Eurobond offerings.

EUROBOND OFFERINGS, 1982-1986
($ Billions)

1986	$182.8
1985	134.5
1984	78.6
1983	47.3
1982	46.8

Source: IDD Information Services

As Eurobond issuance has grown, so has activity in secondary market trading activity in Eurobonds. Secondary market activity in Eurobonds exceeded $3 trillion in 1986; in 1982, this figure stood under $1 trillion. This enormous increase in activity, which in large part takes place in the U.K., has been one of the factors determining U.S. broker-dealer growth in London. The growth in the Eurobond market, both in primary issuance and secondary market trading, has probably been the most important factor in U.S. broker-dealers building up staff and adding to facilities in London. Naturally, as they have added to their production staff, the need for support staff has increased dramatically as well. The Eurobond market probably has been the most important factor in the necessity of U.S. firms having extensive facilities overseas and competing for international business.

U.S. TRADING IN FOREIGN SECURITIES

With U.S. exchanges accounting for about 39% of the world's equity capitalization, U.S. investors have begun to realize that a portfolio need not only represent U.S. companies. U.S. investors have recently shown an increasing desire for foreign equities; such diversification of U.S. investors' portfolios can decrease risk while increasing return.

Foreign Equities

U.S. gross and net activity in foreign securities has a long history but only recently has it blossomed. In the period 1970 to 1978, U.S. gross activity in foreign equities averaged about $4 billion a year (with a low in 1970 of $2 billion and a high in 1978 of $6.8 billion), or only about 16% of the $25.3 billion averaged by foreign investors' in U.S. equities.

However, in 1979, U.S. gross activity in foreign equities moved up to over $10 billion and, except for a blip in 1982, has trended upwards reaching $101.3 billion in 1986.

U.S. GROSS ACTIVITY IN FOREIGN EQUITIES

	Gross Activity ($ Bil.)	As % of Foreign Activity in U.S. Equities
1986	$101.3	36.5%
1985	45.6	28.7
1984	30.4	24.5
1983	30.3	22.6
1982	15.7	19.6
1981	18.8	24.9
1980	17.9	23.8
1975	3.3	12.7
1972	4.7	17.7

Source: U.S. Treasury

The numerous Euroequity offering and privatizations will surely lead to an increased appetite for foreign equities. Recent decisions by the SEC will, under certain conditions, allow greater participation in the international portion of non-U.S. privatizations by sophisticated U.S. investors and U.S. citizens resident in the foreign country of the privatized issue.

A recent survey by the NYSE substantiates this point. According to the exchange, the number of registered representatives and sales offices outside the U.S. increased in 1986 by 13% and 5%, respectively. Moreover, the table on the following page indicates that NYSE full-time producing RRs have increased their presence overseas for 13 consecutive years, with particularly heavy growth commencing in 1979.

DISTRIBUTION OF NYSE MEMBER
FIRM SALES OFFICES AND RRs OVERSEAS

	Sales Offices	Full-Time Producing RRs
1986	280	2,987
1985	268	2,653
1984	N/A	N/A
1983	252	2,286
1982	255	2,233
1981	254	1,996
1980	247	1,733
1979	227	1,698
1978	224	1,369
1977	214	1,314
1976	199	1,178
1975	216	1,039
1974	243	N/A
1973	279	N/A
1972	256	N/A

N/A Not Available

Source: New York Stock Exchange

PENSION FUND FLOWS

U.S. pension fund investment abroad has exploded and all signs indicate this growth will be continued. Data from InterSec Securities, an international investing consulting organization, shows that the portion of U.S. pension funds that invest in the U.S. has grown about 20% per year for the past five years. In comparison, the portion of U.S. pension funds that invest abroad have increased slightly over 50% per year. This explains in great part why U.S. securities firms have devoted considerable resources to building up a research capability in the coverage of foreign securities.

Finally, the growth of U.S. broker-dealers in such markets as London is due, in part, to the increase in pension flows overseas following the removal of U.K. foreign exchange controls in 1979. In the period 1979 to 1985 the "annual flow of U.K. investors' portfolio investment overseas increased from £1 billion to £18 billion and over 90% was done by overseas brokers."[2/] As other countries continue to remove exchange controls, U.S. broker-dealers will have further reason to increase their overseas capabilities.

2/London Stock Exchange Quarterly, Spring 1987, p.15.

U.S. PRIVATE PENSION ASSETS
($ Billions)

	Non-Domestic Assets	% of Total Assets
1990(E)	$130	8%
1986	45	4
1985	27	3
1980	3	1
1975	0	0

(E) Estimate
Source: InterSec Research Corp.

IMPORTANCE OF FOREIGN MARKETS FOR U.S. ISSUERS

Perhaps the most dramatic trend in U.S. broker-dealers developing their international expertise has been the need of U.S. issuers, both public and private, to raise debt overseas.

While the reasons for U.S. overseas debt financing are many, perhaps none has had as great an impact as the huge economic imbalances among industrialized countries. This is particularly true of the huge U.S. deficits and the huge Japanese trade surpluses. With both U.S. government and private entities seeking (and competing for) funds, investment bankers have served as overseas intermediaries, bringing together borrowers and lenders. Technology has greased the wheels, allowing for the geographic separation of borrower and lender. That these lenders happened to be foreign, makes little difference to the borrowers. Indeed, if borrowers were not able to take advantage of overseas capital, U.S. interest rates would be higher.

The U.S. federal government has benefited greatly from foreign attraction to its debt. Indeed, foreign ownership of U.S. public debt securities held by non-bank investors stood at nearly 19% at the end of 1986. While the table indicates that foreign investors' share of U.S. debt holdings has generally declined over the past decade, this is more an indication of the increasing interest among other U.S. investors than waning of foreign interest. In addition, the U.S. government faces "competition" for foreign investors' dollars from the U.S. corporate market's increasing amount of debt which demands financing.

All this being said, the point still remains that foreign investors are still vitally important participants in the public debt markets; their absolute holdings have increased for seven consecutive years.

FOREIGN HOLDINGS OF FEDERAL DEBT BY PRIVATE INVESTORS
($ Billions)

	Total Non-Bank Holdings	Foreign Holdings	
1986	$1,371.9	$255.6	18.6%
1985	1,225.0	214.6	17.5
1984	1,029.1	192.9	18.7
1983	833.8	166.3	19.9
1982	717.0	149.5	20.9
1981	583.1	136.6	23.4
1980	504.3	129.7	25.7
1979	452.4	119.0	26.3
1978	413.6	133.1	32.2
1977	362.4	109.6	30.2

Source: U.S. Treasury

CONCLUSION

In this paper, we have shown that, over time, the amount of funds raised internationally has increased significantly and the U.S. dominance in terms of the world's stock markets has declined dramatically. Foreigners have become important investors in all types of U.S. government and corporate securities, while, in turn, U.S. investors have become much more interested in foreign securities as investment vehicles. Both cyclical and secular reasons have contributed to create a "global village."

These developments have opened up opportunities for U.S. broker-dealers to serve as intermediaries in matching the needs of U.S. customers for capital with foreigners who are able to supply that capital. In seizing this opportunity, U.S. broker-dealers have expanded and established facilities in all parts of the world, and particularly in London and Tokyo. This phenomenon is well on its way and still developing.

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